UNITED
NATIONS

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United Nations
Conference
on Trade and
Development

Distr.
GENERAL

TD/B/COM.1/EM.9/2
16 April 1999

Original: English

TRADE AND DEVELOPMENT BOARD
Commission on Trade in Goods and Services, and Commodities
Expert Meeting on Air Transport Services: Clarifying Issues to Define the Elements of the Positive Agenda of Developing Countries as regards both the GATS and Specific Sector Negotiations of Interest to Them
Geneva, 21-23 June 1999
Item 3 of the provisional agenda

AIR TRANSPORT SERVICES: THE POSITIVE AGENDA FOR DEVELOPING COUNTRIES

Report by the UNCTAD secretariat

EXECUTIVE SUMMARY

The regulatory landscape of international air transport is changing very quickly and at many levels at the same time, reflecting the dynamism of the sector. These changes aim to meet consistently increasing demand for air services around the world through more flexible approaches to regulation. The sector remains, however, very complex from a regulatory perspective. The task of reconciling the need for flexibility with infrastructure, safety and environmental concerns can limit considerably the scope for policy actions. The transition from a primarily bilateral regime to an increasingly "inclusive" regime, even in the absence of physical and other limitations, raises intricate issues whose solutions are not straightforward. For developing countries, active participation in all levels of regulatory change is imperative to ensure that the objectives underlying aviation policy in developing countries are attained and that the efforts made in this connection are compatible. The review of the GATS Annex on Air Transport Services should be compatible with and, to the extent possible, complementary to the work undertaken at ICAO. This is one of the reasons why developing countries may have an interest in approaching the GATS Annex as a building-block instrument which may help in making liberalization more predictable and accountable for all countries.

GE.99-51277 (E)

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I. MAJOR ISSUES IN THE CURRENT AIR TRANSPORT DEBATE

1. Trade in air transport services (ATS) encompasses transport of passengers, cargo, and mail services. Trade performance and services delivery are influenced by the activities of all the actors in the international air transport industry, including airlines (carriers), airports, air traffic control systems and the aircraft industry. Other actors whose dealings have a direct and fundamental impact on the air transport industry are air traffic regulatory bodies, fuel suppliers, aircraft leasing companies and tour operators.

2. The industry has shown remarkable dynamism despite regulatory regimes that are somewhat more restrictive and rigid than regimes applying to other sectors of economic activity. Regulatory innovations and new market arrangements have become necessary to reflect consistently increasing demand for air transport services. The sector exhibits many of the characteristics common to other globalized sectors such as the establishment of international cooperative arrangements and alliances of various types alongside domestic mergers and acquisitions, assisted by advances in information technology. The outsourcing of activities such as accounting and data entry and other computer-related services also make the industry look as global or globalized as any other industry in the world economy.

A. Overall market trends

3. Air transport is one of the world's largest industries, accounting for US$1.14 trillion in annual gross output worldwide and generating 24 million jobs. 1/ The development of air transport is correlated with that of tourism, and each has contributed to the other's expansion. Air transport has expanded at a faster pace than world output over the last 40 years: since 1960, passenger traffic has grown by 9 per cent per annum (p.a.), while air freight has expanded at a rate of 11 per cent p.a. At the same time, world GDP has risen at a rhythm of 3.5 per cent p.a.

4. About 70 per cent of the market for air transport services is accounted for by passenger travel, and 28 per cent by freight, while mail accounts for a small and decreasing portion (2 per cent) of the total volume. The importance of passenger traffic is even higher in terms of revenue, since it generates 88 per cent of the total. Freight accounts for 11 per cent of total revenue and mail for the remaining 1 per cent. One of the salient features of past and future trends in ATS in these segments is the disparity in competitive situations between the air carriers of many developing countries and those of most developed countries.

5. There has been a high concentration of trade in all segments of international air services in North America and Europe during the last three decades. However, the growing importance of the market shares and growth rates of the Asia and Pacific region in all segments of ATS has to be underlined. Forecasts by ICAO predict that the Asia and Pacific region will be the fastest growing region in the world in this respect during this and the next decade. Latin America, the Middle East and Africa will continue growing at a slower pace than the other regions. Three-quarters of international air transport of passengers is accounted for by carriers from developed countries,

and one-quarter by carriers from developing countries. Similarly, about 60 per cent of freight is transported by developed country carriers and 40 per cent by developing country carriers. Among the developing regions, Asia and the Pacific is the most dynamic in all categories, accounting for about 30 per cent of global traffic. The other developing regions, including Latin America and the Caribbean, the Middle East and Africa, together account for 10 per cent.

6. Total income from operating revenues of the world's scheduled airlines during the period 1985-1995 increased at an annual average rate of 7.5 per cent, from US$166.2 to US$291.0 billion. Operating costs (expenses) grew at the same rate, increasing from US$156.0 to US$274.5 billion in the same period. On a regional basis total operating revenues for airlines of North America in 1996 were US$103.1 billion, with an operating result (profit/loss(-)) of US$6.2 billion; for airlines of Europe, US$82.4 and 2.7 billion, respectively, for airlines of Asia/Pacific, US$68.0 and 3.2 billion, for airlines of Latin America and the Caribbean, US$14.3 and 0.3 billion, for airlines of the Middle East, US$8.1 and -.2 billion, and for airlines of Africa, US$6.6 and 0.1 billion.

7. Forecasts of trends in international air transport services during the 1995-2005 period indicate increases from 373 million to 680 million in the number of passengers, from 13 million to 24.4 million tonnes of freight on scheduled services, from 1,241 to 2,395 billion scheduled passenger-kilometres, from 70,273 to 145,720 billion scheduled freight tonne-kilometres (table 1). The severe economic downturn in the Asia Pacific region has had a significant negative impact on domestic and international air traffic within that region and on traffic flows between the Asia Pacific and other regions. Consequently, the forecast growth in billions of passenger-kilometres performed for the Asia Pacific region from 1995 to 2005 has been revised downward from 1,260 to 1,081 and the average annual growth rate from 8.5 to 7 per cent. The forecast for growth in billions of passenger-kilometres performed worldwide has been adjusted downward from 3,807 to 3,629 and the average annual growth rate from 5.5 to 5 per cent.

8. During the period 1988-1997, the world's top 10 countries in terms of international passenger-kilometers performed were the United States of America, the United Kingdom, Japan, Germany, the Netherlands, Singapore, France, the Republic of Korea, Australia and Canada. Some developing countries appeared among the world's top 30 in terms of passenger-kilometres during the same period (see table 2). Among the top 30 transporters of the world, 13 were from developing countries.

B. Demand and supply conditions

9. Changes in world production, trade and investment on the demand side and technological and pricing factors on the supply side have been responsible for the remarkable growth of air traffic, which has doubled in each of the past three decades, growing at about twice the rate of global GDP. 2/ Future growth of air transport services will continue to depend primarily on world economic and trade growth and airline costs (highly dependent on fuel prices), as well on the extent to which the industry faces up to major challenges such as airport and airspace congestion, environmental protection and increasing

capital investment needs. The shape and size of air transport systems will also be affected by governmental decisions, notably those determining the type and extent of economic regulation of airlines.

C. Demand factors affecting ATS

10. ICAO projections of expected growth in demand for ATS (in particular in Asia and the Pacific) depend on macroeconomic forecasts of sustained world economic growth (resulting in higher disposable incomes), but demand for ATS will also depend on more specific developments such as: 3/

- Growth of international and domestic tourism, for both leisure and business purposes (see below). Approximately 40 per cent of international tourist arrivals are by air transport, but this share should rise in the future;

- Globalization and the growing integration and inter-penetration of economies, leading to an expansion of the flow of business-related travel among and within countries, thus raising the density of air traffic. One of the aspects of this process is the incorporation of new regions/countries into international flows, which widens the geographical scope for air transport expansion;

- The continuing trend towards lower air fares (which in real terms have fallen by 40 per cent since the mid-1970s);

- The growth of the share of high-value/low-bulk products in the manufacturing and trade of industrialized countries, combined with the application of just-in-time and lean production management techniques, where time is of paramount importance. This leads to increased air freight demand; 4/

- The rise in the share of services in total output. The services sector is more travel-intensive than manufacturing;

- Increases in the international movement of labour, which gives rise to both business and personal travel;

- The trend towards several shorter periods of travel in the course of a year, rather than one long period of vacation;

- Increased consumption of fresh perishable foodstuffs originating in distant countries (which necessarily have to be transported by air);

- Air traffic liberalization.

11. On the supply side, important developments have taken place which have been changing the aviation landscape. First, the gradual relaxation of tariff structures has been responsible in large measure for the movement towards freer trade and competition conditions in the industry. The introduction of the advanced purchase excursion fare (APEX), itself a response by the scheduled airlines to the growing importance of non-scheduled (charter) traffic, introduced great competition and consumer satisfaction in an

otherwise very insulated sector by promoting a general lowering of tariffs based on discounts for advance purchase and compliance with other additional conditions (e.g. limitations on the length of stay). In addition, fares became more flexible as benefits for the regular consumer were introduced, such as the frequent flyer programmes. 5/

12. Second, carriers have organized systems to combine traffic from converging routes at a central "hub". This phenomenon began in the United States as a consequence of the domestic liberalization that took place in the late 1970s. Internationally, the "hub-and-spoke" system has played an important role in the evolution of competition among carriers, since it has required carriers to develop an international (or internationalized) strategy to connect hubs and spokes within and beyond national borders. The pressure for the creation of truly global networks through hubs and spokes has been a recent characteristic of aviation relations.

13. In the development of global networks, different carriers have dealt with market pressures to develop global networks in different ways. Only a very few have gone it alone, attempting to develop their own systems. Others have resorted to marketing alliances, sometimes involving cross-ownership arrangements, which allow them to link hubs through practices such as code-sharing. Estimates from the OECD indicate that to date nearly 200 airlines have been involved in establishing over 500 alliances. 6/ Most of these have involved code-sharing arrangements where carriers can appropriate network benefits without actually investing in the expansion of their own networks. The popularity of code-sharing derives also from the fact that it constitutes a powerful instrument for carriers to maximize the use of traffic rights, especially when these are granted in the form of serving any point within and beyond a bilateral partner. Criticism about code-sharing has focused on its effects on competition and consumer satisfaction. 7/ Alliances in general, and code-sharing in particular, have put great competitive pressure on airlines by introducing a pragmatic way to facilitate business in spite of existing regulatory limitations.

D. Regulations

14. The regulation of international air transport services comprises both multilateral and bilateral agreements involving Governments and airline companies. The current regulatory framework can be traced back to the 1940s when the failure to achieve a widely accepted and comprehensive multilateral agreement on the exchange of economic rights during or immediately after the conclusion of the Chicago Conference in 1944 led States to rely primarily on bilateral agreements for that purpose. At present, some 1,950 such agreements are filed with ICAO in accordance with Articles 81 and 83 of the Chicago Convention. Many other agreements are known to exist but have not yet been registered. Both multilateral and bilateral regulatory practices have evolved since. With a few exceptions, however, global multilateral regulation has stayed away from market access, focusing on technical and safety aspects of international flights. The evolution of both the bilateral, and more recently, the regional multilateral regimes has been in the direction of greater flexibility and liberalization.

E. Bilateral regulation

15. Since the Chicago Conference, international air transport regulation has been based primarily on bilateral air service agreements, through which decisions on market access for air carriers, pricing and quantity of services supplied are taken by States in the exercise of sovereignty over their air space. Traditionally, such agreements were based on reciprocity and included predetermination of capacity, double approval of tariffs, and routes of specific cities to be served (see Box 1). Usually one or two airlines were designated as flag carriers in international flights and thus enjoyed exclusive rights in these markets.

16. The most influential bilateral development in the aftermath of the Chicago Conference was the 1946 bilateral agreement between the United Kingdom and the United States; the Bermuda I Agreement provided that tariffs were to be established by the airlines through IATA, subject to approval by both parties with capacity subject to ex post facto review. The so-called Bermuda-type agreement became a model for the decades to come, but its expected liberal effect was diminished by airline pooling agreements and other capacity sharing arrangements. The bilateral agreements, inspired or not by Bermuda, had, however, a very stabilizing effect on the regulation of air transport and in large measure permitted and ensured the enormous growth of the industry in the post-war period.

17. Over the last 15 years, many bilateral agreements have been renegotiated to make their provisions more flexible and liberalize them. Though there are many different degrees to which this has been done, typically the new agreements make more flexible (or abolish) state control over frequencies, capacity and prices (which are to some degree left to be determined by the market) and increase or do not limit the number of designated carriers. This reorientation of bilateral air service agreements is underscored by many of the same factors which led to domestic liberalization (quest for greater efficiency and competition, lower prices, etc.).

18. Some of the major events that have set the new direction of international air transport policy have been the US-Netherlands bilateral agreement of 1978 and the announcement by the US Department of Transportation in 1992 of the pursuit of the open skies policy. This was aimed initially at liberalizing air traffic with (Western) Europe and, subsequently, with other countries. During the same year, an open skies agreement was signed with the Netherlands, and during the following years, several other open skies or very liberal agreements were signed with European countries (Austria, Belgium, Denmark, Finland, Luxembourg, Sweden, Norway, Switzerland, Iceland and Germany). In 1995, a bilateral US-Canada agreement was signed, foreseeing the significant liberalization of transborder air traffic within three years.

19. The bilateral regime began to include related commercial rights (sometimes referred to as "soft rights") as a result of a Standard Agreement for Provisional Air Routes adopted at the Chicago Conference. This Standard Agreement included provisions on non-discriminatory user charges, customs and immigration procedures, aviation fuel tax exemption, and ownership and control criteria (a designated airline was to be substantially owned and effectively controlled by the designating State or its nationals). Although a clause

granting designated airlines a "fair and equal opportunity to compete" often served to resolve related commercial issues, as the industry grew States found it necessary to include specific bilateral provisions on such matters as currency conversion and remittance of earnings, sale and marketing of air services, office establishment and airline representation(entry and residence of non-national personnel), reciprocal exemption from income taxes, ground handling, code-sharing, computer reservation services, and aircraft leasing. Some have argued that the inclusion of such matters in bilateral agreements derived principally from the lack of a better place to put them, a situation which perhaps will change further with the advent of the GATS and its annex on air transport services (see chapter III below).

F. Regional regulation

20. In addition to bilateral agreements, there are also regional multilateral arrangements both for the comprehensive economic regulation of international air transport and for important aspects of it. Five prominent examples are presented below.

21. **European Union (EU)**. Member States have, over a period initially of 10 years and in three distinct phases, established a regulatory regime aimed at the creation of a single market for intra-Europe air services. 8/ The last of the liberalization "packages" took effect on 1 January 1993, accomplishing the extension of EU regulation to areas such as licensing, market access, pricing, capacity and competition, computer reservation systems and airport access. The Third Package for the first time created an EU-wide aviation market where an EU person (individual or company), irrespective of nationality, could create an air carrier anywhere within the unified market and from there operate wherever market opportunities arose, without any need for government permission to do so. In addition, the distinction between scheduled and non-scheduled air services was eliminated so that airlines could decide for themselves according to market conditions the type of service they were willing to supply. Price setting was also left to airlines to decide, along with the level of capacity they wanted to offer in the market. 9/

22. **Andean Pact**. The member States of the Andean Pact, namely Bolivia, Colombia, Ecuador, Peru and Venezuela, by Decision 297 of the Commission of the Cartagena Agreement, agreed in 1991 to establish an "open skies" area where all five freedoms of the air would be granted without restrictions on intra-zone traffic to all member-State airlines. 10/

23. **Caribbean Community**. The Multilateral Agreement Concerning the Operation of Air Services within the Caribbean Community was concluded on 6 July 1996 among 14 Caribbean States, namely Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago. The Agreement entered into force 11 December 1998.

24. **MERCOSUR.** The Fortaleza Agreement, signed on 17 December 1996, is the first agreement on air services negotiated by MERCOSUR countries, namely Argentina, Brazil, Paraguay and Uruguay, and its associate members, Bolivia

and Chile. The Agreement established freedom of the air for subregional airlines for intra-zone traffic on routes not served by existing bilateral agreements. 11/

25. **South-East Asia**. An Agreement was concluded on 14 January 1998 by Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam for subregional air transport cooperation.

26. It should be noted that although all multilateral regional agreements have some things in common, such as application to all scheduled air services and the granting of first and second freedoms, they vary considerably with respect to important elements such as tariffs, capacity and multiple designation. Other work being undertaken regionally among developing countries includes the Yamoussoukro Declaration, which has recommended shifting the focus to subregional efforts and to strategic airline alliances. In that regard, the Banjul Accord to implement the Declaration for six African States (Cape Verde, Ghana, Guinea-Bissau, Sierra Leone, Nigeria and the Gambia) was concluded on 4 April 1997. 12/

G. Liberalization trends

27. The original impulse to liberalize international air transport policy has come from the policy adopted by the United States to extend the deregulation of its domestic market to international routes. Similarly, the liberalization of the West European internal market has led to a push for the international expansion of such policies in the market of Central and Eastern European countries, which should align themselves with the European airline policy over the medium term.

28. Among developing countries and territories, significant liberalization has taken place, for instance between Argentina and Chile, Venezuela and Colombia, Guatemala and Panama, Ethiopia and the United Arab Emirates, Bahrain and Malaysia, and Macau and Nepal.

29. The significant shift in the direction taken by international air transport policy over the last 15 years 13/ has come about within the context of the existing international institutional framework. The more liberal bilateral agreements and the open skies agreements are still agreements between two States (which can, however, affect third countries in the case of fifth and sixth freedom rights), although their clauses are significantly more flexible than traditional bilateral agreements. They fall under the regime set by the Chicago Convention. On the other hand, there are some market mechanisms which are increasingly putting pressure on the existing international regulatory framework. Alliances among airlines of different countries and their practice of code-sharing, for instance, can allow carriers preferential access to behind-gateway feed traffic, and franchising can indirectly circumvent nationality clauses in bilateral agreements and constraints on foreign ownership of national airlines.

30. On the other hand, some of the regional regulatory initiatives described above aimed at greater flexibility of rules which go beyond the existing international bilateral regulatory framework. They involve the adoption of

regional regulation of air traffic, either complementing or superseding the bilateral structure. Regional air transport policy is part of the wider process of regional economic integration.

31. These initiatives seem to indicate a trend towards regionalization of air transport policy, mostly undertaken as part of the construction of common markets or economic integration processes which imply close economic integration between member countries. The existing regional initiatives on air transport do not treat the aviation sector as part of their discipline for trade in services, but establish a common separate air transport policy.

II. PROBLEMS FACING DEVELOPING COUNTRIES

A. Trade interests

32. The history of aviation in the developing world, although undergoing constant evolution and change, has had an important aspect in common with the developed world: an overriding motivation in aviation policy to ensure the existence of a national flag carrier. The interest in having their own national airlines explains much in the attitudes of developing countries. First of all, there is the perception that being connected to the outside world is of crucial importance given the vagaries of world politics and economic relations. Countries, in particular the developing ones, feel especially hesitant to forego having a national carrier when experience proves that in times of emergency, war or other crises, lower traffic and isolation do penalize affected countries. Another important reason for maintaining a national airline has to do with the function that may be performed indirectly by international services in making feasible the supply of domestic services. It has been quite common for developing countries to rely on the profits made by the international portion of national airlines to finance domestic services which can be just as costly as they are necessary for development reasons. Other reasons for maintaining a national carrier relate to developmental issues such as the need to ensure technological and managerial transfers or the generation of foreign exchange.

33. Governments throughout the world are increasingly recognizing the need to adapt aviation policies, which have traditionally been more concerned with protecting the interests of their national airlines rather than the interests of the consumers (passengers and shippers). In fact, a much broader policy framework has for some time been influencing decisions in air transport. For example, aviation policies that restrain competition limit the potential of growth in tourism; the lost opportunity can be extremely serious.

34. The challenge is for developing countries to reconcile a number of potentially conflicting objectives such as protecting national carriers and easing domestic traffic restrictions with a view to achieving greater competition and lower prices. Such conflicts generally derive from the fact that air transport plays a dual function for developing countries: it ensures external links to the major trading centres while at the same time providing for economic and social development, whether through its contribution to other economic sectors or through the provision of social services, for example to remote areas and communities.

35. This reconciliation of potentially conflicting objectives is taking place in a dynamic context of the restructuring of airlines to favour greater efficiency and competitiveness, as well as in a changing international regulatory landscape. Despite the urgency of legitimate development-related objectives, developing countries are increasingly having to face the need to reduce and/or eliminate subsidies while securing a place in the market for their airlines, joining airlines from developed countries in devising ways to provide for more traffic at lower prices and of better quality. Developing countries, while in the past they could afford to protect national carriers, now have to find market-oriented ways to bypass traditional barriers to greater participation in international traffic or else risk being fully excluded from the market.

B. Economic issues and public policies

36. Expansion of trade in air transport services calls for a proactive attitude on several fronts. The need to stimulate efficiency and quality through greater competition applies to both the domestic and the international markets, albeit with varying degrees of intensity. Measures such as the de-restricting of domestic regulations on airline and airport designation, alongside the liberalization of fare structures, have done much to promote greater competitiveness in terms of both price and quality, as a result of which national airlines can improve their chances in international markets as well. On the international front, greater freedom for charter flights has also had the same effect while adding greatly to the availability of air services for countries which do not happen to be well placed in relation to the major international routes. 14/

37. Other measures that have contributed to increasing the participation of developing countries in trade in air transport services include investing in the improvement of the national airline or, alternatively, promoting its privatization. Additionally, developing countries have been very active in the negotiation of new bilateral and, in some cases, plurilateral regional agreements. 15/ The main question here is whether the negotiation of increasingly liberal agreements can in fact provide for the necessary security, predictability and increased participation of developing countries or whether a more nuanced approach may be necessary (see chapter III, below).

38. There are a number of issues of special relevance from a public policy perspective. In what follows, the most important ones will be reviewed with respect to air transport services in general and the implications for developing countries in particular.

(a) Pricing policies

39. Pricing is an area that has traditionally been characterized by much cooperation among air carriers, although with liberalization individual pricing by air carriers is becoming the norm, particularly on major air routes. For developing countries, tariff agreements and the system of interlining have been responsible for a greater participation of their airlines than would otherwise have been the case. Tariff coordination has favoured developing country and other small and medium-sized airlines by providing them with sales access in the systems of larger airlines. This has

had the effect of helping to ensure the presence of these airlines in international markets, which is good for beneficiary airlines as well as for the overall level of competition thus preserved in air transport. Another important element in price-setting and coordination for developing countries has been the prevention of predatory behaviour on the part of airlines that could, with relative ease, drive unprepared or new entrant airlines out of the market by pursuing aggressive pricing strategies. 16/ For this and other reasons, therefore, it could be said that the current pricing system may be adequate to accommodate the main needs of developing countries in this area.

(b) Routes, traffic rights, capacity

40. **Routes**. A route is determined by the points (cities) served by an airline and therefore effectively represents the market of that airline. Typically, Governments agree bilaterally on the routes on which traffic will be carried, often involving traffic between one or more specific gateways in the home country and one or more gateways in the foreign country. Countries may indeed have more than one gateway to which traffic may be assigned, and large countries usually do. In strictly bilateral negotiations, therefore, larger countries tend to have greater bargaining power by virtue of the fact that they can offer more than one gateway to trading partners. Small and developing countries that do not have more than one gateway are often disadvantaged ab initio in this aspect of bilateral negotiations, particularly if such negotiations are conducted on the basis of a very rigid reciprocity approach to the matter. However, tourist traffic potential and a geographic location conducive to sixth freedom operations can often compensate for the bilateral imbalance in negotiating strengths.

41. **Traffic rights**. These refer to the type of traffic that countries grant each other in their agreements. The ability to carry traffic beyond or behind a particular city or cities can determine in large measure the competitiveness of air carriers. Countries that have well developed domestic hub-and-spoke systems have an advantage in both the domestic and international markets because they can achieve comparatively more than other countries in the realization of economies of scale and/or scope. For developing countries, the competitive challenge in establishing international networks and obtaining the rights with which to do so is rather formidable. In the absence of large traffic volume and synergy in domestic operations, developing country air carriers arrive on the international market without the benefits of economies of scale or scope. Even when the airline is relatively efficient, obtaining beyond rights may be a very difficult proposition, given the disparities in bargaining power between a developing country and a country that has much to offer in a bilateral negotiation. 17/

42. **Capacity**. This refers to a quantitative measure of the supply of an air transport service, usually expressed in terms of aircraft, passenger seats and/or units of weight or space, and frequency of a particular air service. 18/ For developing countries, negotiations on capacity are made especially difficult by a number of factors, including concepts such as reciprocity or fair and equal opportunity to compete which results in any increases in capacity by the airline(s) of the developing country being matched by a stronger competitor. The argument in favour or against capacity controls in the context of the participation of developing country airlines in

the world market varies from case to case, depending on the particularities of each airline, route and so on. It should not be forgotten that the experience with controlled capacity has in many ways also helped developing country carriers by guaranteeing them a minimum threshold of traffic while protecting them against capacity and price dumping by the larger and financially stronger carriers. In addition, the effective control of capacity by carriers at both ends of a specific route has traditionally been a reliable means of ensuring higher fares, thus also pushing up company profitability of both carriers.

(c) Distribution, marketing and cost-cutting strategies and alliances

43. Airlines work on improving service quality, advertising their product to differentiate it from competing products, building consumer confidence through quality and marketing, and lowering costs to achieve a lower final price for the service they supply. Until recently, airlines could in large measure rely on bilateral agreements as a guarantee of a comfortable share of any particular market. With increased competition being introduced via liberalization efforts, airlines have had to become much more market-driven and they have done so in a number of ways. Their use of sophisticated yield management programmes and computer reservation systems (CRSs), as well as the rapid pace with which mergers and alliances have become common in the industry, attest to the power of adaptation of air carriers despite regulatory rigidities. Even when they manage to achieve low costs in their operations, developing country airlines have great difficulty surviving and growing on that alone. In addition to low cost, they need to develop and supply quality services alongside successful marketing strategies in order to gain some space in the market. Strategic alliances, often based on regional relationships, have proven to be a reliable response to this level of competitive pressure. 19/ Another response, particularly in relation to the difficulties involved in establishing brand identity, is the practice of franchising, whereby a new entrant pays an agreed sum to a major international carrier to be able to rely on its expertise, reputation and assistance. 20/

44. It should be noted that the gap between the developed and the developing world in terms of market and marketing know-how and capabilities is so large in some cases that it is very difficult to see how developing countries' best efforts could be rewarded in the absence of some market "guarantees". There have been cases where smaller national carriers from developing countries, despite being very cost-efficient, needed some protection in order to compensate for the marketing advantages of major international airlines derived, among other things, from the very large scale and scope of their operations. Bilateral agreements, particularly the predetermination types with their capacity controls, have performed a crucial function in that context, in effect insulating smaller airlines from the full force of international competitive pressures. 21/

(d) Subsidies

45. The granting of subsidies has been very widespread in the aviation sector. The most prominent forms of subsidies are restructuring subsidies, cross subsidies and social subsidies. Restructuring subsidies have become increasingly important as liberalization evolves in world markets and airline companies demand support in order to adjust toward lower costs and greater

competitiveness. The difficulty with restructuring subsidies is the distortions to competition they clearly introduce. Even in cases where the stated purpose is to avoid the distortion of competition, it may still not be easy to determine the extent of the effect of non-commercial aid to a particular air carrier on overall supply and demand conditions. Subsidies justified on social grounds, such as the need to ensure minimum levels of service to remote areas, have been primarily domestic in nature. The argument in favour of such subsidies hinges on the criteria applied and the definitions used to justify them.

46. For developing countries, the main issue relating to the issue of subsidies may be their lack of funds and other competing priorities such as health and education for limited budgetary resources. Developing countries do subsidize airlines, especially where there is complete or partial state ownership of the carrier, thus facilitating capital injections and other forms of aid such as the provision of collateral for loans. In many cases, the logic of aid in the developing world is based on restructuring and social objectives in much the same way as in the developed world. Given the differences in scale of support, developing countries may do better to push for limits on the granting of state aid, since they may be the great victims of the distortions introduced by such aid.

(e) Competition policies

47. The discussion on competition law has often touched on whether domestic regulation should be generic or sector-specific, while at the international level the main focus has been on the possible harmonization of national laws or at least the reduction of differences in their application. Aviation has raised a number of sector-specific issues such as multilateral tariff coordination, international airline alliances, and airport slot allocation (an airport slot is a designated time for an aircraft to land or take off).

48. Developing countries in many cases do not even regulate competition. The issues relating to competition, however, are of great interest to these countries, especially as the world liberalizes air transport and more competitive carriers from other nations become freer to resort to predatory behaviour. Short of achieving the harmonization of competition law - a very ambitious objective indeed - developing countries could possibly benefit from some form of mechanism that could attenuate, albeit temporarily, the effects of market openness.

49. With the liberalization of air transport and the gradual move towards more openness in the skies, however, the need to safeguard "fair competition" has become more evident as carriers, in the context of increasing freedom, may at times resort to practices detrimental to competition. These may include, for example, fares below costs, the addition of excessive capacity or frequency of service, or the abuse of dominant position in a route.

(f) Ownership rules

50. Although the trend is toward privatization, the first important consideration with regard to ownership rules refers to the fact that a significant portion of the developing world still operates state-owned air

carriers. There are important exceptions, but poor management by public authorities combined with the lack of restructuring "initiative" in airlines that traditionally rely on state aid to continue to operate has made the possibility of private ownership very attractive. The justification for the growing number of airlines with foreign ownership or equity is just a natural result of the internal debate in many developing countries about public ownership. Foreign ownership usually comes with greater know-how and expertise, and developing countries have increasingly relied on that sort of privatization effort.

51. Ownership rules have been very restrictive under the traditional bilateral regime, and in many cases that has been to the detriment of increased participation of developing country airlines in the international market. Developing countries, whose investment regimes have often been liberalized, may achieve greater market access through more flexible ownership and control provisions under bilateral or other agreements. More flexible ownership criteria have raised fears of the proliferation of flags-of-convenience in aviation which may impair safety and have the effect of allowing carriers to establish in tax havens and avoid the national flag for tax reasons. Developing countries have an interest in preventing this from happening but must continue to explore ways to ensure that their liberalized investment regimes are accepted by bilateral partners.

(g) Non-regulatory limitations

52. *Market positioning*. The challenge for developing country airlines is to find and maintain a place in the market. With increased competition in international markets, developing country airlines can no longer rely solely on restrictive bilateral agreements as a means to market access. In fact the issue is no longer how to "guarantee" a certain level of market access but rather how to ensure an increasing level of access commensurate with the dynamism of international competition. In order to do so, airlines have to be attractive enough to be accepted as members of alliances, as partners in code-sharing and other cooperative arrangements, as enterprises that may be successfully privatized through national or foreign capital, or as companies capable of absorbing market solutions such as franchising or other arrangements with world-class airlines. In the absence of a market-oriented mindset, developing country airlines will increasingly have difficulty in preserving their share of traffic in international routes; regulatory regimes can only benefit airlines that prepare themselves for increased competition. Even with the existing regulatory regime, which is far from liberal in general terms, a carrier can hardly insulate itself from competition. Competitive pressures force the pace of restructuring and adjustment, which in turn are prerequisites for surviving irrespective of regulatory reform. Given that the orientation of regulatory reform itself is toward the elimination of transaction barriers, market-oriented solutions are all the more urgent for those that have not yet sought them.

53. *Physical and other limitations*. To expect increased participation of any airlines, from developing or developed countries, may be unrealistic if infrastructure and other limitations relating to airport and airspace capacity are not taken into account. Congestion continues to be a major problem in most of the world's prominent airports as a result of continuous traffic

growth, government measures, evolving travel patterns, environmental concerns and credit tightening. Measures relating to noise, for example, have had a considerable dampening effect on airport expansion. In addition, the lack of airport slots is bound to curtail expansion plans as airlines, particularly those from developing countries which have had no access to certain hubs, can foresee no guarantee of effectively using access which has in principle been granted. Providing for regulatory regimes which on paper ensure greater access is therefore not enough, since infrastructure limitations can render that access null and void in practice. Another important limitation is the infrastructure situation of the developing countries themselves, which often is not sufficient to facilitate the achievement of the necessary quality and efficiency levels in the operation of domestic and/or international air services.

III. ACTIONS TO ADDRESS THE PROBLEMS

A. ICAO and the developing countries

54. ICAO's 1994 World-Wide Air Transport Conference recognized the general objective of a "gradual, progressive, orderly and safeguarded change towards market access in international air transport regulation". 22/ It also recognized that a liberalized regulatory regime would only be credible if it "provided for sustained participation by all States, including developing ones". 23/ In addition, the Conference looked into the issue of preferential measures for carriers of developing countries with a view to addressing possible approaches that could help carriers from developing countries sustain the increasing competition from the much more powerful carriers from developed countries. Pursuant to a recommendation from the Conference, the ICAO secretariat produced a study on preferential measures for developing countries whose focus was "on increasing participation rather than providing protection". 24/ In addition, on 30 May 1997 the ICAO Council approved six recommendations, including one on participation measures, which, albeit non-preferential in nature, addresses the interest of developing countries in achieving greater presence in the market through flexible approaches to market access. 25/

55. All measures suggested in the ICAO study on preferential measures, although intended as examples that could be applied by developing countries at any level of their regulatory relationships, could certainly be considered in the context of an evolving multilateral regime for air transport services. Essentially, all measures call for non-reciprocity in a number of important aspects of economic regulation such as routes, fifth freedom rights and capacity. The logic here is to allow some additional market access for developing countries in order to compensate for their deteriorating competitive position in international markets. Unless these countries have a "head start", they will not be able to establish a credible presence in the market before competition from major air carriers makes it impossible altogether.

56. Another way of preserving a certain level of flexibility for developing countries suggested in the ICAO study relates to trial periods, phasing-ins and faster-pace liberalization among developing countries. All three suggestions aim at allowing developing countries to experiment provisionally

with liberalization in whichever way they choose before going at it in a definitive manner. This form of flexibility has the advantage of being reasonably proactive, engaging developing countries in actual liberalization, albeit it in the absence of a longer-term commitment. Liberalization and its competitive effects could then be monitored for future reference in application to other cases.

57. Developing countries may have an interest in including safeguard measures also addressed in the 1994 ICAO Conference. Safeguard measures have as their objective to ensure continued participation by any and all air carriers in the event of unforeseen or temporary circumstances which may, among other things, cause significant economic damage to any carrier. 26/ With increasing liberalization and competition, developing country airlines are more likely to suffer from "surges" of foreign air services in routes served by them, and developing countries may indeed have a greater interest in pressing for the inclusion of safeguard mechanisms into the existing and future regulatory regime.

B. The GATS and the Annex on Air Transport Services

58. Like all other services sectors, air transport services are covered by GATS disciplines. However, the application of the Agreement to the sector is qualified by provisions contained in an Annex specifically devoted to air transport. The manner in which the sector is addressed in the GATS Annex provides vivid proof of the complexity of the sector and of the suspicion with which policy-makers and industry operators view wide-ranging liberalization in the sector. 27/ From the very first draft of the Annex in the Uruguay Round, its main feature was a broad carve-out of all traffic rights and "services directly related to the exercise of air traffic rights" from the scope of application of GATS disciplines. In fact, most of the work devoted to the crafting of the Annex related to the scope of the carve-out. In that sense, the solution embodied in the Annex revealed a compromise between those who wanted a very limited application of the GATS to aviation and those who wished to ensure that the coverage of the sector be meaningful enough to engage the sector in a truly multilateral liberalization process. The Annex provides in its paragraph 5 that: "The Council for Trade in Services shall review periodically, and at least every five years, developments in the air transport sector and the operation of this Annex with a view to considering the possible further application of the Agreement in this sector".

59. Forty countries made initial commitments in at least one of the three air transport services covered by the GATS. Thirty-three countries made commitments in maintenance and repair, 26 in sales and marketing and 23 in computer reservation systems (CRS) services. Regarding the application of the MFN principle, 28 countries took exemptions regarding at least one of the three types of services covered by the Agreement. Most of these exemptions related to CRS services and the sale and marketing of air transport.

60. As has been stressed above, supply-side factors common to other service sectors, such as quality, efficiency and a favourable image, are vital for penetration of the world market for air transport services. Like other service sectors, air transport has a public service function which has to be taken into account, and public and national security considerations are

important. What particularly distinguishes the air transport sector are the physical limits to liberalization and the existing regulatory structure in which the degree of negotiated market access is the determining factor in market penetration. To increase their share in the market for air services, developing countries must concentrate on strengthening their negotiating position in obtaining greater market access for their airlines and enhancing the position of their airlines in negotiating alliances, code-sharing and blocked space agreements with the major developed country airlines.

61. In order to consider approaches to achieving greater market access for developing country airlines in the context of the positive agenda for future negotiations on services, the following paragraphs examine the possibilities for achieving this goal in the context of negotiations in the WTO, bearing in mind that the WTO Council on Trade in Services will review the "possible further application" of the GATS to the air transport sector in 2000.

62. Much further liberalization of air transport services can be achieved within the existing parameters of the Annex on Air Transport Services. WTO Members can remove MFN exemptions, as well as increase the number and level of commitments on "paragraph 3" services, i.e. aircraft repair and maintenance, selling and marketing of air transport services, and CRS services. Developing countries would, however, have to assess the degree to which they can compete in these sectors. Some have demonstrated competitiveness in the provision of aircraft maintenance services.

63. Attempts have been made at the national level and at the multilateral level in ICAO to address the risk of anti-competitive practices flowing from liberalization. WTO negotiations could deal with such issues through: (i) a multilateral agreement on competition policy; (ii) strengthening the rather weak provisions of Article IX of the GATS; or (iii) special sectoral rules (i.e. analogous to the annex to the Protocol on Basic Telecommunications Services which was suggested in the Expert Meeting on Tourism) as an inclusion to the Annex which would address the competition policy problems specific to the air transport sector as a whole.

64. Developing countries simply cannot afford the level of support which some developed countries grant to their air carriers, whether for restructuring or for other purposes. Article XV of the GATS provides that members shall enter into negotiations with a view to developing multilateral disciplines to avoid trade distortive effects, while recognizing the role of subsidies in relation to the development programmes of developing countries, providing them with special and differential treatment along the lines of the Agreement on Subsidies and Countervailing Measures. Such disciplines would apply to the air transport sector, as it would be difficult to agree that subsidies are directly related to air traffic rights. While these new disciplines are being negotiated, Article XV provides for exchange of information and consultations when a Member considers that it is adversely affected by a subsidy of another Member.

65. The next question relates to paragraph 2 (b) of the Annex on "services directly related to the exercise of traffic rights". The WTO secretariat, in its note for the Council for Trade in Services, has drawn attention to definitional problems which leave the coverage of this exclusion unclear.

The WTO secretariat points to a number of elements contained in the current Annex on Air Transport Services, the national schedules of commitments and the GATS itself which could be revised for greater legal clarity. 28/ For example, according to the secretariat note, it is not clear whether the aircraft leasing sector, which is of major economic importance (over 18 per cent of the world's aircraft fleet is either owned by leasing companies or leased by other airlines or manufacturers) is covered by the GATS. Thus, an important element in the review of the GATS Annex would be to establish an agreed definition as to the scope of paragraph 2 (b). One directly related service that is often mentioned as a candidate for inclusion is ground handling. However, there are also wide variations in the extent to which a liberal stance on supply by foreign companies is regarded as appropriate. Another activity often mentioned may actually be considered a full subsector of the air transport service sector: air cargo services. With respect to air cargo services, for example, countries vary in their share of passenger and cargo services, and especially with respect to combination or "combi" services where both passenger and cargo are carried on the same aircraft and are subject to the same regulatory regime.

66. The crux of the issue of market access for developing countries in the air transport sector concerns the air traffic rights which have been specifically excluded from the coverage of the GATS (i.e. paragraph 2 (a) services in the Annex). From the perspective of the positive agenda of developing countries, the question is whether the incorporation of air traffic rights or certain components of such rights would improve their market access. As noted above, the scope of traffic rights extends to routes (i.e. the eight freedoms), capacity, tariffs and other elements.

67. With respect to the category of services directly related to the exercise of traffic rights, many of the bilateral provisions which relate to commercial presence, the movement of natural persons and the remittance of earnings would normally fall within the GATS negotiating framework. Others, dealing with unfair pricing practices and the abuse of dominant positions, could be dealt with by improved disciplines in the area of competition policy in the forms suggested above. It could be envisaged that a multilateral decision could de-link these elements from bilateral air traffic agreements and confine the exception, if it were decided to retain it, to the three essential elements, namely, routes, tariffs and capacity.

68. The aspect of the GATS which has preoccupied air transport negotiators from the beginning has been the general obligation to grant unconditional MFN treatment. This obligation would apply even if the specific air traffic agreements were not inscribed in the Schedules of Commitments, unless a sectoral-specific sectoral derogation were made under Article II.2. What would unconditional MFN imply? One aspect is that the terms of an open skies agreement between two large countries, e.g. the United States of America and Canada, or the United States and the EU, would have to be extended unconditionally to all WTO members, including those which were not necessarily prepared to enter into such open skies agreements.

69. If this possibility is viewed in isolation, the obvious question arises as to what interest the two countries subscribing to the open skies agreement could have in extending the same access unconditionally to others? However,

when seen in the broader perspective of the GATS, it must be noted that in sectors such as financial services and basic telecommunications, where the developed countries possess the competitive advantage, developing countries have been obliged to extend all their commitments on an unconditional MFN basis.

70. With respect to the negotiation of routes in general, MFN treatment would imply at the more detailed level that, if two countries agreed to mutually extend fifth freedom rights, for example, those countries would have to grant fifth freedom rights to airlines from all other countries. With respect to capacity and tariffs (fares), the extension of MFN treatment would appear even more complicated, although there is a trend towards freely determined capacity and prices and fair and equal opportunity to compete provisions in bilaterals have generally allowed competing air carriers to match capacity and pricing in international markets. It could be envisaged that the review of the air transport Annex could lead to an extension of the GATS to cover paragraph 2 (b) services, certain elements of bilateral air traffic agreements, notably the "other elements" category, and possibly the allocation of routes.

71. Extension of the GATS would imply that specific commitments with respect to air transport could be included in the Schedules of Commitments. These would have to phrased in MFN terms, and any subsequent modification would involve renegotiation and possible compensation, including in other service sectors or in tariff rates on goods. All such commitments, as well as the generally applicable obligations (notably unconditional MFN treatment), would be subject to the WTO Dispute Settlement Understanding. Furthermore, any new obligations in the area of subsidies or competition policy which are particularly relevant to air transport would apply to those elements of the air transport sector "integrated" into GATS.

72. As has been noted above, the weak position of developing countries in the negotiation of bilateral air traffic agreements is seen as a major impediment to their increasing their penetration of world markets for air transport services. Incorporation of air transport into the GATS WTO framework is seen as enabling developing countries to strengthen their negotiating position via trade-offs between air transport and other sectors. Developing countries which attach priority to expanding their air transport exports could offer concessions in other areas, e.g. access to trade in goods of interest to the main "market" developed countries. Alternatively, developing countries which do not attach priority to maintaining a strong national airline could offer access in the air transport sector in return for other concessions. Whether this potentially improved bargaining position could be applied effectively in practice is another question, and the ability of subregional groupings among developing countries to maintain a common negotiating position could be a determining factor.

73. This bargaining position should in principle be enhanced by the provisions of Article IV, which oblige members to facilitate the increasing participation of developing countries in world trade in services through negotiated specific commitments, including those of particular importance to the air transport sector, such as those relating to access to technology on a commercial basis, improvement of access to distribution channels and information networks.

74. The study mentioned above which the Secretary-General of ICAO circulated in January 1997 suggests a self-contained preferential system in the air transport sector, setting out nine "potential preferential measures for consideration and possible use by States" provides an alternative, or supportive approach. These suggested preferential measures include: (a) asymmetric market access liberalization; (b) more flexibility for developing country airlines in relation to capacity, code-sharing, etc.; (c) trial periods in introducing new liberal air service arrangements; (d) longer phase-in of market access arrangements; (e) accelerated liberalization among developing countries; (f) waiver of ownership and effective control requirements; (g) waiver of restrictions on use of leased aircraft; (h) preferences in the use of airport slots; (i) longer phase-in periods for liberalization in the areas of ground handling, currency conversion and remittance, employment of nationals and CRS.

75. The most constructive approach to the parallel initiatives in WTO and ICAO could be to ensure that actions in each forum are mutually compatible. For example, the GATS could be extended to cover paragraph 2 (b) services, including many services that are normally included in bilateral air traffic agreements. The preferential measures suggested in the ICAO secretariat study could be applied to the residual aspects of air traffic rights, i.e. paragraph 2 (a) of the GATS Annex minus the elements of air traffic agreements that would be incorporated into the GATS. ICAO estimates that about 55 per cent of the 379 bilateral agreements, amendments and memoranda of understanding reportedly concluded from 1 January 1995 to 31 December 1998 had one or more participation measures (such as multiple designation, flexible capacity provisions, or more liberal treatment for non-scheduled and cargo services). This could be the beginning of a trend, and if that were the case eventually the trend could somehow be reflected in the disciplines to emerge out of the GATS or its Annex on Air Transport Services. In this context, much depends on what a review of the Annex could produce with regard to the relationship between the GATS and existing regulatory regimes.

76. The ICAO study on preferential measures in favour of developing countries suggested a number of measures which could be incorporated into arrangements of various types negotiated by developing countries. The question for the GATS Annex Review is whether any of those measures could or should be incorporated into the annex itself as an additional recognition of the legitimacy of non-reciprocity in multilateral air transport relations.

77. First, it should be noted that a wide recognition of the legitimacy of non-reciprocity for developing countries would only make limited sense, since the scope of application of the GATS provisions to air transport is itself limited. Thus, a number of recommendations regarding market access, for example, would only have an effect on the GATS if the Annex were revised to include traffic rights, since only then would GATS apply to the right to serve cities, the granting of fifth freedom rights, and the right to operate greater capacity - all traffic-right-related recommendations. The recommendations on ownership and control criteria and on "doing-business" matters would be the only ones that could be applicable in the context of the current coverage of air transport services under the GATS. 29/

78. Second, the approach to development and developing countries would need to conform to the treatment the GATS itself foresees for that issue. Article IV of the GATS on the increasing participation of developing countries has avoided a special and differential treatment approach to developing countries in favour of a proactive, pro-market approach based on the negotiation of specific commitments aimed at the strengthening of the services capacity of developing countries through access to technology on a commercial basis, as well as improvement of their access to distribution channels and information networks. Article IV would apply to all aspects of the air transport sector "integrated" into GATS. If the core elements of air traffic rights were to remain outside of the GATS, it would be envisaged that the GATS Annex could recognize the importance of applying the ICAO recommendations with respect to traffic rights. Based upon the ICAO premise, stated in the study, that "the growth of international air transport in developing countries will serve the interest of all States", 30/ which stemmed from the desirability of introducing or maintaining greater participation and competition wherever possible in the sector, may in fact corroborate the overriding nature of preferential and participation measures under GATS, as well as elsewhere.

79. Article XXVIII of the GATS has a number of definitions, including that of a juridical person that is "owned" or "controlled" by persons of a WTO Member. A revision of this provision with respect to air services suppliers could be of interest to developing countries, since more flexible approaches to ownership and control could facilitate their access to aviation markets. For example, if a jointly or foreign owned airline that has a principal place of business in a developing country could be considered an air service supplier from that developing country, that would already constitute a broadening of the definition which would help many developing countries to increase their market access. ICAO has suggested that and other approaches (such as the concept of "community of interest" for developing countries in the same economic grouping) in both its study on preferential measures and in the recommendations by the Air Transport Regulation Panel. 31/ The revision of definitions relating to ownership and control is relevant to the activities already included in the GATS Annex.

Box 1

AVIATION RIGHTS

First freedom rights grant a foreign carrier the right to fly over the home country without landing.

Second freedom rights grant a foreign carrier the right to land at specified points in the home country, for purposes of refuelling and maintenance, but not to pick up or disembark traffic (passengers, cargo, or mail).

Third freedom rights allow for traffic that was picked up by a foreign carrier outside the home country to be disembarked at specified destinations in the home country.

Fourth freedom rights allow a foreign carrier to pick up originating traffic in the home country, for transport to the foreign country in which the carrier is based.

Fifth freedom rights (also called beyond rights) permit the foreign carrier to pick up or disembark traffic en route.

Sixth freedom rights allow the unofficial right to pick up and put down traffic between foreign States via home State (by combining third and fourth freedom rights).

Seventh freedom rights grant the right to pick up and put down traffic between two foreign States.

Source: Derived from data in Doganis (1991). Courtesy of John Bowen.

Table 1

Top 30 countries or groups of countries in 1997 and their ranking in 1996 and 1988 in terms of traffic carried on their airlines' scheduled services[1]

PASSENGER-KILOMETRES PERFORMED					FREIGHT AND MAIL TONNE-KILOMETRES PERFORMED				
		Ranking					Ranking		
Country or group of countries	Estimated 1997 (mill)	1997	1996	1988	Country or group of countries	Estimated 1997 (mill)	1997	1996	1988
United States	267 753	1	1	1	United States	15 917	1	1	1
United Kingdom [2]	151 052	2	2	2	Republic of Korea	7 960	2	3	7
Japan	84 098	3	3	3	Japan	7 643	3	4	2
Germany	82 258	4	4	5	United Kingdom [2]	6 735	4	2	5
Netherlands	70 465	5	5	9	Germany	6 267	5	5	3
Singapore	55 459	6	7	6	France	5 129	6	6	4
France	53 781	7	6	4	Singapore	4 872	7	7	8
Republic of Korea	51 954	8	8	15	Netherlands	4 435	8	8	6
Australia	48 554	9	9	7	Switzerland	1 887	9	10	12
Canada	40 928	10	10	8	Australia	1 808	10	9	10
Italy	29 285	11	11	14	Canada	1 669	11	11	11
Thailand	27 747	12	12	10	Thailand	1 638	12	14	16
Switzerland	26 160	13	15	13	Italy	1 457	13	12	9
Brazil	25 537	14	14	18	China [5]	1 396	14	18	22
Malaysia	24 029	15	13	25	Hong Kong SAR [6]	2 274	-	-	-
Spain	23 235	16	16	11	Malaysia	1 364	15	13	26
Gulf States [3]	21 576	17	17	24	Brazil	1 358	16	15	15
New Zealand	19 970	18	18	19	Israel	1 142	17	16	13
Russian Federation	18 135	19	19	-	Gulf States [3]	1 132	18	17	32
Scandinavia [4]	16 609	20	21	16	Chile	993	19	20	30
Indonesia	16 182	21	22	21	Saudi Arabia	863	20	19	19
China [5]	15 781	22	20	30	New Zealand	778	21	21	27
Hong Kong SAR [6]	19 341	-	-	-	Scandinavia [4]	727	22	23	20
Philippines	14 431	23	24	22	Indonesia	696	23	24	21
Saudi Arabia	13 061	24	23	17	Belgium	691	24	25	14
India	12 877	25	25	20	Spain	675	25	22	17
South Africa	11 940	26	27	33	Russian Federation	513	26	26	-
Israel	11 492	27	26	26	Philippines	479	27	30	29
Belgium	11 277	28	28	28	India	443	28	27	18
Mexico	10 983	29	29	23	South Africa	397	29	32	34
Austria	9 940	30	30	53	Pakistan	387	30	28	24

Source: ICAO Air Transport Reporting Form A-1 and IATA.

1. Most 1997 data are computer-generated estimates, and thus the ranking and the rate of increase or decrease may change when final data become available.

2. Excludes the traffic for Hong Kong, China, for the last six months of 1997.

3. Four States, namely, Bahrain, Oman, Qatar and United Arab Emirates, are partners in the multinational airline "Gulf Air".

4. Three States, namely, Denmark, Norway and Sweden, are partners in the consortium airline "Scandinavian Airlines System".

5. The ranking of China is preliminary. For statistical purposes, the data for China exclude the traffic for the Hong Kong Special Administrative Region (Hong Kong SAR) for the last six months of 1997 and that of Taiwan Province of China.

6. Traffic for the Hong Kong Special Administrative Region (SAR) for the last six months of 1997.

Table 2

Top 30 scheduled air carriers in 1997 and their ranking in 1996 and 1988 in terms of scheduled traffic carried[1]

PASSENGER-KILOMETRES PERFORMED					FREIGHT AND MAIL TONNE-KILOMETRES PERFORMED				
		Ranking					Ranking		
Carrier	Estimated 1997 (mill)	1997	1996	1988	Carrier	Estimated 1997 (mill)	1997	1996	1988
British Airways	99 086	1	1	1	Lufthansa	6 249	1	1	1
United	76 228	2	2	11	Korean Air	5 619	2	2	6
Lufthansa	66 385	3	4	4	Air France	5 056	3	3	3
JAL	62 030	4	3	2	SIA	4 841	4	4	9
Air France	60 751	5	9	6	JAL	4 027	5	6	2
American	55 878	6	5	13	KLM	3 971	6	5	5
KLM	55 595	7	8	9	British Airways	3 876	7	7	7
SIA	55 459	8	6	5	Cathay Pacific	3 621	8	8	10
Northwest	52 370	9	7	8	Federal Express	3 483	9	9	43
Qantas	44 137	10	10	7	United	2 672	10	10	25
Cathay Pacific	38 942	11	11	12	Northwest	2 093	11	11	8
Delta	36 907	12	13	23	Swissair	1 885	12	15	14
Korean Air	34 206	13	12	20	American	1 862	13	12	29
Alitalia	28 720	14	14	19	Nippon Cargo	1 856	14	13	15
Thai Airways	27 747	15	15	14	Asiana[2]	1 769	15	19	-
Swissair	24 901	16	17	17	Qantas	1 687	16	14	13
Air Canada	24 147	17	18	21	Thai Airways	1 637	17	18	19
Malaysian Airlines	24 004	18	16	32	Alitalia	1 443	18	16	12
Iberia	21 539	19	19	15	Malaysian Airlines	1 364	19	17	34
Virgin Atlantic	19 158	20	22	53	Delta	1 335	20	22	42
Air New Zealand	18 340	21	20	27	United Parcel[2]	1 240	21	21	-
All Nippon Airways	18 306	22	24	46	Polar Air Cargo[3]	1 223	22	26	-
Continental	17 376	23	33	18	El Al	1 141	23	20	16
Canadian	16 781	24	21	25	Air Canada	1 059	24	24	20
Varig	16 717	25	25	26	Varig	1 037	25	23	18
SAS	16 157	26	23	22	Lan Chile	896	26	37	47
Garuda	15 592	27	26	28	All Nippon Airways	885	27	28	49
PAL	14 431	28	29	29	Saudia	863	28	25	26
Saudia	13 061	29	27	24	Air China[4]	824	29	29	-
Asiana[2]	12 527	30	31	-	Air New Zealand	810	30	27	36

ENDNOTES

1/ These output and employment data include direct, indirect and induced impacts of the air transport industry (Air Transport Action Group, The Economic Benefits of Air Transport (1994 data), Geneva, 1997).

2/ OECD, The Future of International Air Transport Policy, Paris, 1997, p. 8.

3/ Traeger Rolf, "The international air transport industry and policy: present state, trends and outlook", mimeo, June 1998.

4/ ICAO estimates that each 1 per cent rise in world exports produces a 1.5 per cent increase in demand for cargo services (ICAO, The world of civil aviation 1993-1996, Montreal, 1994).

5/ Lyle, Chris, The Future of International Air Transport Regulation, 1995, p.

6/ OECD, The Future of International Air Transport Policy, p. 87.

7/ It is not uncommon for passengers to be disappointed when they are informed that the equipment that will take them from one city to another is the equipment of an airline other than the one that appears on his/her ticket.

8/ The first liberalization package of 1988 outlawed pool agreements as anti-competitive. The second package in 1990 allowed fifth freedom operations anywhere in Europe, while limiting saleable capacity to 50 per cent on the primary service. The third package of January 1993 brought complete access to all destinations within the EU in third, fourth, fifth, sixth, seventh and eighth freedoms. Van Fenema, H. Peter, The Liberalization of Air Transport Services in the European Union: Some Recent Developments in the Field of EU External Relations, Beijing, 1995, p. 1.

9/ Sorensen, F., "Aviation in the Community: The new legal framework", keynote address in the international colloquium on "The New Legal Framework for Aviation in the European Community", Paris, 17 June 1993, pp. 1-2.

10/ ICAO, "Regional air service arrangements in South America and the Caribbean", Workshop on Air Transport Regulatory Policy, San Jose, Costa Rica, 18-22 August 1997.

11/ MERCOSUR, The Agreement on Sub-regional Air Services between Argentina, Bolivia, Brazil, Chile, Paraguay and Uruguay.

12/ ICAO, Annual Civil Aviation Report 1997, p. 15.

13/ This does not mean totally free markets are being adopted, but rather that policy is being designed to reap the benefits of more liberal regimes. (OECD, The future of international air transport policy. Responding to global change, Paris, 1997, p. 116).

14/ UNCTAD, "International trade in tourism-related services: Issues and options for developing countries", background note by the UNCTAD secretariat, TD/B/COM.1/EM.6/2, 2 April 1998, pp. 11-12.

15/ Ibid., p. 13.

16/ Whether curtailing predatory pricing behaviour is justified given the many other imperfections in the international aviation market is beyond the scope of this study. OECD, The Future of International Air Transport Policy, p. 66.

17/ As developing countries have often upheld in international forums, their bilateral bargaining power may be limited but it is still better than not having any such power under a full market access approach to regulation.

18/ ICAO, Manual on the Regulation of International Air Transport, AT Conf/4-WP/5, Appendix, Part 4.3, p. 1.

19/ Regional alliances among smaller developing countries have proven to be very successful as in the case of the TACA Group in Central America. In addition, regional alliances may also become interesting partners for larger carriers, as the TACA Group itself shows, having established an alliance as a group with American Airlines. ICAO, "Air access: the impact of air transport on tourism; policy options and strategies for developing countries", paper presented by Charlie Dudley at the Expert Meeting on Strengthening the Capacity for Expanding the Tourism Sector in Developing Countries, UNCTAD, Geneva, 8-10 June 1998, p. 4.

20/ The practice is not fully free of controversy, particularly when the major airline object of the franchise does not hold the underlying route authority for the services being operated by another airline in its name. Ibid., p. 4.

21/ The case of Cyprus Airways is often quoted in this context. OECD, International Air Transport: The Challenges Ahead, pp. 64-65.

22/ ICAO, "Secretariat study on preferential measures for developing countries in the economic regulation of international air transport", attachment to State Letter EC 2/75-97/1, p. 1.

23/ Ibid.

24/ Ibid., p. 2.

25/ For example, the recommendation on participation measures addresses the desirability of providing for less strict capacity arrangements, a feature which would work in favour of countries with lesser bargaining power in bilateral negotiations. ICAO, Recommendations by the Air Transport Regulation Panel (ATRP), Participation Measures, 30 May 1997, ATRP/9-3.

26/ On 30 May 1997, the ICAO Council approved a recommendation by the Air Transport Regulation Panel (ATRP) on a safeguard mechanism (ATRP/9-1).

27/ The Punta del Este Declaration recognized that life in some sectors would not be easy by stating the need of elaborating "sectoral disciplines" for individual sectors. By the time the round had reached its mid-term review meeting, no solution had been found to the "coverage" issue. The Montreal Declaration in some ways aggravated the situation by its reference that certain sectors may be excluded. The sectors which could be addressed by this reference included the air transport sector.

28/ See the "Background note by the secretariat on air transport services", WTO, S/C/W/59, 5 November 1998, pp. 16-18.

29/ If the Annex were revised to permit application of GATS rules and principles by those countries opting to do so through their schedule of commitments, the application of preferential measures could also be considered.

30/ "Background note by the secretariat on air transport services", WTO, S/C/W/59, 5 November 1998, p. 9.

31/ In the recommendation regarding the broadening of airline ownership and control criteria, the issue of flags of convenience was addressed through the proposal that a criterion based on a combination of principal place of business and permanent residence with a strong link to the designating State be adopted.